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September 7, 2004

VIA ELECTRONIC MAIL ON SEPTEMBER 7, 2004
AND HAND-DELIVERY ON SEPTEMBER 8, 2004
South Carolina Public Service Commission
ATTN: Docketing Department
PO Drawer 11649
Columbia SC 29211

RE: Application of Total Environmental Solutions, Inc. for Adjustment of Rates and Charges for Provision of Water and Sewer Collection
Docket No. 2004-90-W/S, Our File No. 557-10022

To Whom It May Concern:

Enclosed for filing please find and original and ten copies of a corrected **Proposed Order** for filing by Total Environmental Solutions, Inc. ("TESI") in the above-referenced docket. When I arrived at the Commission at 4:45 PM on Friday, September 3 to file TESI's original Proposed Order, I learned that the Commission court reporter had been forced to reorder and repaginate Volume 2 of the Transcript I had receive last Wednesday in order to correct certain defects. TESI drafted its original Proposed Order based upon the incorrectly paginated Volume 2. I have revised that Proposed Order to correct the pagination and all references to the witnesses and hearing exhibits presented in this proceeding.

The late delivery of Volume 2 also made it impossible for TESI's rate consultant to perform a review of its Proposed Order, causing the financial and monetary values contained in Findings of Fact 10–12 of the Proposed Order to be either incomplete or incorrect. The enclosed Proposed Order also corrects this portion of TESI's original Proposed Order.

TESI respectfully requests that the Commission and all parties replace TESI's original Proposed Order with the corrected Proposed Order attached hereto. In order to ensure that all parties receive a copy of this Proposed Order as early as possible, I am serving them with this letter and the attached Proposed Order by electronic mail service on September 7, 2004.

With kind regards, I am

Yours truly,

John F. Beach

John F. Beach

cc: Mr. Paul Maeder Mr. Bill Schoening Mr. Gary Shambaugh
All parties of record [VIA ELECTRONIC MAIL SERVICE]
Attachments

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STATE OF SOUTH CAROLINA

BEFORE THE PUBLIC SERVICE COMMISSION

DOCKET NO. 2004-90-W/S – ORDER NO. 2004-

SEPTEMBER ____, 2004

IN THE MATTER OF:	)	
	)	
Total Environmental Solutions, Inc.	)	**ORDER RULING ON**
Application for Increase in Rates and	)	**APPLICATION FOR**
Charges for Water and Sewer Services	)	**INCREASE IN RATES**
	)	

I. INTRODUCTION

This matter is before the Public Service Commission of South Carolina (the "Commission") on the Application of Total Environmental Solutions, Inc. ("TESI" or the "Company"), filed on March 17, 2004, seeking approval of a new schedule of rates and charges for water and sewer service that TESI provides to its customers within its authorized service areas in South Carolina. The Application was filed pursuant to S.C. Code Ann. Section 58-5-210 *et seq.* (1976), as amended, and 26 S.C. Regs. 103-821 (1976).

By letter dated March 30, 2004, the Commission's Executive Director instructed TESI to publish a prepared Notice of Filing, one time, in newspapers of general circulation in the areas affected by TESI's Application. The Notice of Filing indicated the nature of the Application and advised all interested persons desiring to participate in the scheduled proceedings of the manner and time in which to file appropriate pleadings for inclusion in the proceedings. In the letter of March 30, 2004, the Executive Director also instructed TESI to notify directly, by U.S. Mail, each customer affected by the

Application by mailing each customer a copy of the Notice of Filing. TESI furnished the Commission with an Affidavit of Publication and an Affidavit of Mailing demonstrating that the Notice of Filing had been duly published and mailed to all customers affected by the Application in accordance with the instructions of the Executive Director. In response to the Notice of Filing, Petitions to Intervene were filed on behalf of Elliott F. Elam, Jr., Acting Consumer Advocate for the State of South Carolina (the "Consumer Advocate"), the South Carolina Department of Health and Environmental Control ("DHEC"), and the Foxwood Hills Property Owners Association, Inc. (the "POA").

S.C. Code Ann. Section 58-3-95 (Supp. 2001) provides in relevant part that "[w]henever a corporation or person furnishing … water, sewerage collection, sewerage disposal, … files a schedule setting forth proposed changes with the Commission pursuant to the procedures prescribed in this title, a panel of three members of the Commission shall hear and rule on the proposed changes." Pursuant to S.C. Code Ann. §58-3-95 (Supp.2001), the Chairman of the Commission appointed the panel to hear and rule on TESI's Application. The panel consisted of Commissioner Mitchell, Commissioner Clyburn, and Commissioner Moseley.

In addition to the scheduled hearing during normal Commission hours, the Commission held a public night hearing on July 26, 2004.[1] On August 24, 2004, the public hearing relative to the matters asserted in TESI's Application was commenced in the Commission's hearing room located at Synergy Business Park, 101 Executive Center

[1] The purpose of the night hearing was to provide a forum, at a convenient time and location, for customers of TESI to present their comments regarding the service and rates of TESI. The hearing was held in Walhalla, near where TESI provides service and where the customers had requested a public forum.

Drive – Saluda Building, Columbia, South Carolina. Chairman Mitchell presided at that hearing.

During the proceedings, TESI was represented by John F. Beach, Esquire. The Consumer Advocate was represented by Elliott F. Elam, Jr., Esquire. DHEC was represented by Mason A. Summers, Esquire. The POA was represented by H. Asby Fulmer III, Esquire. The Commission Staff was represented by F. David Butler, General Counsel.

At the night hearing on July 26, 2004, and at the public hearing on August 24, 2004, customers of TESI presented testimony to the Commission concerning their views of the requested rates and experiences with the Company's service. At the hearing on August 24, 2004, the Company presented Paul Maeder, TESI's Chief Executive Officer, Bill Schoening, TESI's Assistant General Manager, and Gary D. Shambaugh, Executive Vice President of AUS Consultants – Weber Fick & Wilson Division, as its witnesses. The Commission Staff presented the testimony and accompanying exhibits of Sharon G. Scott, an Auditor for the Public Service Commission of South Carolina, and William O. Richardson, Chief of the Water and Wastewater Division of the Commission's Utilities Department. DHEC presented the testimony of Raymond F. Peterson, an Environmental Engineer for the Capacity Development Program within DHEC's Water Facilities Permitting Division. The POA presented the testimony of Bill Lewis, comptroller/manager for the POA, and Michael Dodson. The Consumer Advocate did not present a witness.

In considering the Application of TESI, the Commission must consider competing interests. The interests of the consumers to receive quality service and a quality product at a reasonable rate compete with the interests of the provider to have the opportunity to earn a fair rate of return. Regulation, as it has developed in the United States, is concerned with rates, service, [and] safety … . Charles F. Phillips, Jr., *The Regulation of Public Utilities*, (1993) at 171. Rate regulation has two aspects: control of the rate level (earnings) and control of the rate structure (prices). *Id.* As to the rate level, public utilities are entitled to cover all allowable operating costs and to have the opportunity to earn a "fair" rate of return. *Id.* Collectively, these items comprise a company's total revenue requirements. *Id.* As to the rate structure, public utilities are permitted to establish rates that, at a minimum, will cover their revenue requirements. *Id.* at 171-72. Such rates must be "just and reasonable," with no "undue" discrimination. *Id.* at 172.

Thus, in considering the Application of TESI, the Commission must give due consideration to the Company's total revenue requirements, comprised of allowable operating costs and the opportunity to earn a fair rate of return. To this end, the Commission will review the operating revenues and operating expenses of TESI and will endeavor to establish adequate and reasonable levels of revenues and expenses. Further, the Commission will consider a fair rate of return for TESI based upon the record before it. Should the Commission's determination show that rates should be increased, the Commission will then design rates for TESI that are just and reasonable.

II. FINDINGS OF FACT

1. TESI is a water and sewer utility providing water and sewer service in its assigned service areas within South Carolina. TESI's provision of utility service to its water and sewer customers in South Carolina is subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. § 58-5-10, *et seq.* (1976), as amended.

2. The appropriate test year period for the purposes of this proceeding is the twelve-month period ending December 31, 2002, including known and measurable changes through the date of this hearing.

3. The Commission will use operating margin as a guide in determining the lawfulness of the Company's rates and in the fixing of just and reasonable rates.

4. By its Application, TESI is seeking an increase in its rates and charges for water and sewer service equal to $538,490, which results in $788,433 of additional revenues to TESI.

5. The appropriate operating revenues for TESI for the test year under present rates and after accounting and pro forma adjustments are $252,924.

6. The appropriate operating expenses for TESI for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of test-year occurrences are $409,752.

7. The appropriate rate base for TESI for the test year after accounting and pro-forma adjustments it $3,749,759.

8. The operating margin for the test year under present rates and after accounting and pro forma adjustments approved herein is (_____________)%.

9. Based on the operating margin for the test year after accounting and pro forma adjustments, we find that TESI has demonstrated the need for an increase in rates.

10. When applied to as adjusted test year operations, the rates requested and proposed by TESI, as adjusted by its testimony, result in an operating margin of 20 %. The Commission finds that this operating margin is reasonable and appropriate for TESI's Foxwood Hills operations.

11. The income requirement for TESI, using the operating margin of 20 % found appropriate in this Order and the adjusted operating expenses of $__________, is $788,433.

12. In order for TESI to have the opportunity to earn its income requirement of $788,433, TESI must be allowed additional revenues totaling $535,509. In order to meet this requirement, the Commission approves the rate schedule attached hereto as Appendix A.

III. EVIDENCE AND CONCLUSIONS

In this section, the Commission sets forth the evidence relied upon in making its Findings of Fact as set forth in Section II of this Order.

1. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 1

The evidence supporting this finding concerning the Company's business and legal status is contained in the Application filed by TESI and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. This finding of fact is essentially informational, procedural, and jurisdictional in nature.

2. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 2

The evidence supporting this finding, that the appropriate test year period for the purposes of this proceeding is the twelve-month period ending December 31, 2002, is contained in the Application filed by TESI and in the testimony and exhibits of the parties' witnesses.

On March 17, 2004, TESI filed its Application requesting approval of the rate schedules designed to produce an increase in gross revenues of $791,414. TESI's Application was based on a test period consisting of the twelve-months ending December 31, 2002. *See* Application p. 4 and Exhibits to the Application. The Staff likewise offered their evidence generally within the context of the same test period. *See* Hearing Exhibit Nos. 7, 9.

A fundamental principle of the ratemaking process is the establishment of a test year period. In *Heater of Seabrook v. Public Service Commission of South Carolina,* 324 S.C. 56, 478 S.E.2d 826 (1996), the Supreme Court of South Carolina noted that "[t]he 'test year' concept is very important in the rate-setting process. In order to determine what a utility's expenses and revenues are for purposes of determining the reasonableness of a rate, one must select a 'test year' for the measurement of the expenses and revenues." 478 S.E.2d 828 n.1 (1996). The test year is established to provide a basis for making the most accurate forecast of the utility's rate base, reserves, and expenses in the near future when the prescribed rates are in effect. *Porter v. South Carolina Public Service Commission,* 328 S.C. 222, 493 S.E.2d 92 (1997), citing *Hamm v. S.C. Pub. Serv. Comm'n,* 309 S.C. 282, 422 S.E.2d 110 (1992). The test year provides a basis upon which a commission staff will conduct its audit of a company's books. Phillips, *The Regulation of Public Utilities* at 196. For rate-making purposes, only just and reasonable expenses are allowed; only used and useful property (with certain exceptions) is permitted in the rate base. *Id.* The commission must have a basis for estimating future revenue requirements. *Id.*

The Commission concludes that the appropriate test year to use in the instant proceeding is the twelve-moth period ending December 31, 2004. No party contested the use of that test year as proposed by TESI in its Application. To the contrary, all parties relied upon that test year period in presenting their evidence.

3. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 3

In its Application, TESI has proposed operating margin as the appropriate rate setting methodology. Application of TESI, p. 3. The Commission Staff has taken this same approach. See Hearing Exhibit 7.

"The Public Service Commission has wide latitude to determine an appropriate rate-setting methodology." *Heater of Seabrook v. Public Serv. Comm'n of South Carolina*, 324 S.C. 56, 64, 478 S.E. 2d 826, 830 (1996). S. C. Code Ann. Section 58-5-240 (H) (Supp. 2001) directs the Commission to specify an allowable operating margin in all water and wastewater orders.

None of the parties contested the Company's request for operating margin treatment. The Commission finds that operating margin methodology is the appropriate rate-setting methodology to use in this case.

4. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4

The evidence for the finding concerning the amount of the requested rate increase is contained in the Application filed by TESI and in the testimony and exhibits of Staff witness Richardson. The Application of TESI indicates that it is seeking additional revenues of $319,508 from water operations and additional revenues of $220,557 from sewer operations, totaling $540,065. Application of TESI, Appendix B, p. 1, Appendix C, p.1 . Staff witness Richardson testified that under the rates proposed in the Application, TESI would see an increase in revenues of $538,490, or an increase of 215.45%, over present rates. Richardson Prefiled Testimony, p. 2, ll. 20-24, Hearing Exhibit No. 9, p. 7. TESI did not contest the Staff's calculation, and no other party presented any evidence that the requested increase does not amount to $538,490. Therefore, the Commission finds that TESI is seeking an increase in its revenues of $538,490.

5. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 5

The Application of TESI shows per book test year total operating revenues of $113,642 from water, and $148,728 from sewer, for a total adjusted operating revenue of $262,370. Application of TESI, Appendix B, p. 1, and Appendix C, p. 1. Following the Staff's audit of the Company's books and records, Staff calculated test year total operating revenues of $252,924. Hearing Exhibit 11, Audit Exhibit AC. TESI did not contest the Staff's calculation, and no other party presented any evidence to dispute the Staff's calculation of per book test year total operating revenues. Therefore, the only undisputed evidence before the Commission on per book total operating revenues is the $252,924. Therefore, the Commission finds that the appropriate per book test year total operating revenues are $252,924.

6. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 6

The parties offered certain adjustments affecting operating expenses for the test year. TESI witness Shambaugh and Staff witness Scott offered testimony and exhibits detailing adjustments proposed by the parties. *See*, Hearing Exhibits 2 and 4 (Exhibits sponsored by TESI witnesses Maeder and Shambaugh), Hearing Exhibits 7 and 8 (Exhibits sponsored by Staff witness Scott). This Section will address the adjustments offered which affect operating expenses.

(A) DHEC Revenue and Expenses

(1) Position of the Company: The Company agrees with the Staff.

(2) Position of Staff: The Staff proposes to remove DHEC's passthrough revenues and expenses from the per book numbers. The Staff adjustment is ($3,221) to miscellaneous income, and ($2,989) to General and Administrative expenses. These fees are not regulated by the Commission.

(3) Decision of the Commission: The Staff adjustment is adopted, since we agree that these fees are not regulated by the Commission.

(B) Direct Wages and Benefits for South Carolina Employees

(1) Position of the Company: The Company used an anticipated hourly wage and allocated a portion of the expenses to the Lockhart operation, and proposes a combined adjustment of $65,444.

(2) Position of Staff: The Staff used hourly rates as of May 2004 and wages and benefits information as of April 2004 to compute the expenses for employees' health, dental, and retirement benefits, and proposed a combined adjustment of $46,401.

(3) Position of the Company on rebuttal: TESI testified that the $19,043 difference between its adjustment and the Staff's is caused by TESI's loss of a field technician. TESI witness Shambaugh testified that this position is "necessary and important to the proper operation of the utility," Transcript ("TR") Vol. 2, p. 236, and that the position has not been filed "simply for lack of funds." *Id.*

(3) Decision of the Commission: The difference between the two positions results primarily from the loss of one employee, a field technician, that the Company did not replace. Staff contends that it did not include the field technician in its adjustment since it was not a known and measurable change. The Company, however, based its proposed adjustment on actual amounts it had recently paid to fill this position. Amounts that were incurred, at least in part, during the test year. TESI testified that this position was "necessary and important to the operation of the utility." The Staff testified that it was not disputing TESI's expressed need for the additional field technician. TR. Vol. 3, p. 62. Consequently, the only evidence in the record is that TESI needs to fill this position in order to properly operate the utility. We agree with TESI and adopt its adjustment of $65,444.

(C) Increase in Purchased Water

(1) Position of the Company: The Company proposes to adjust expenses to reflect an increase in purchased water costs in the amount of $2,321.

(2) Position of Staff: Staff at first opposed the adjustment, but in surrebuttal testimony, concurred in it.

(3) Decision of the Commission: The $2,321 adjustment is appropriate and is granted.

(D) Increase in Purchased Power Costs for Booster Stations

(1) Position of the Company: The Company originally proposed to reflect an increase in purchased power costs for booster stations, which would have amounted to a combined adjustment of $20,000.

(2) Position of the Staff: During the audit, the Company informed Staff that this adjustment should have been eliminated, since the booster stations were not purchased. Staff, accordingly, did not make this adjustment.

(3) Decision of the Commission: The adjustment is eliminated.

(E) Coutract Operation Expenses

(1) Position of the Company and Staff: At first, both Company and Staff proposed to remove contract operation expenses for the daily operation of the wastewater treatment plant, lab work sample, transporting of monthly reports to DHEC, and collection of water

samples along with other maintenance work, under a belief that the Company's employees began to perform this work during 2003. However, after the audit, it was revealed that contract operations were still ongoing. The Company provided invoices accordingly for the monthly charges of $3,000 and verified the amounts to the 2003 general ledger. Staff agrees with the inclusion of $36,000 for contract services.

(2) Decision of the Commission: The Commission adopts the adjustment.

(F) <u>Insurance Expenses</u>

(1) Position of the Company: The Company proposes an adjustment for the increase in insurance premiums for General Liability, Worker's Compensation, Vehicle and Pollution Liability/Environmental Impairment. The Company's adjustment is based on estimated premiums allocated to its South Carolina operations. The Company's proposed combined adjustment is $22,831.

(2) Position of the Staff: The Staff proposes an adjustment for the increase in insurance premiums, based on actual premiums for the period December 23, 2003 through December 23, 2004, allocated to South Carolina. The Staff's proposed combined adjustment is $14,165.

(3) Decision of the Commission: The Company and Staff used basically the same methodology for the adjustment. The differences are due to the following: The Staff used the actual invoice amounts for the premiums for the period covering December 2003 to December 2004 and the Company used estimated amounts; the Staff allocated a portion of the general liability insurance to the corporate office; the Staff allocated a portion of

the general liability insurance adjustment to the unregulated Lockhart operation based on customers, and the Company only allocated 1% to Lockhart; the Company also allocated 1% of the remaining insurance expenses to Lockhart, and the Staff did not allocate Workers' Compensation to Lockhart. See Surrebuttal testimony of Staff witness Sharon Scott at Tr. Vol. 3 at 35. After due consideration, we adopt Staff's adjustment. Using actual premium amounts is preferable to using estimated amounts. Also, it seems reasonable to adopt Staff's approach on its allocations of insurance expenses to Lockhart.

(G) Allocation of Affiliate Services

(1) Position of the Company: The Company proposes to include an allocation of affiliated services for the corporate office located in Baton Rouge, Louisiana and from the parent company, South Louisiana Electric Cooperative Association (SLECA). This adjustment consists of several components, including corporate office space, corporate office operating costs, corporate salaries, wages & benefits, and other corporate costs. The Company provided an extensive study that specifically allocated components by the cost of service provided. One of the main variables is the allocation factor utilized to apportion these costs to TESI's South Carolina operations. The Company utilized a sophisticated allocation formula that took into account relevant factors such as relative size of the facilities. The company also included a 5% coverage factor for corporate office operating costs to allow for the possibility of the non-recovery of affiliated operating costs. The Company proposes combined adjustments to general and administrative expenses of $52,565, to depreciation and amortization expenses of $2,737,

and to taxes other than income of $1,948. This allocates approximately 3.9% of the Company's total affiliated expenses to South Carolina.

(2) Position of the Staff: Staff used the same methodology to compute the Affiliated Services Charge as the Company, with the exception of the Debt Service Costs and Facilities Costs. Staff proposes combined adjustments of $34,044 to general and administrative expenses, $0 to depreciation, and $1,369 to taxes other than income. The differences in amounts are mainly due to the elimination of the 700 Lockhart customers from the computation of Allocation Factor No. 1 and Allocation Factor No. 2. Staff states that the Lockhart system is a contract customer with little to no work done from the corporate office for the Lockhart system. Only one bill is sent to the Town of Lockhart. Additional differences between Staff and Company adjustments are the disallowance of depreciation expense and elimination of the 5% and 20% coverage factors.

(3) Decision of the Commission: We adopt TESI's adjustments. The Staff's approach to adopt allocation factors based solely upon respective customer population ignores the fact that the Foxwood system, which is currently configured to serve almost 4,000 customers, must be maintained in its entirety. We believe that TESI's approach, which results in an allocation of approximately 3.9% of TESI's operational costs to this system, more accurately reflects the relative cost of operating this system, and ensures that TESI's other state operations are not required to subsidize its South Carolina rates. TESI's adjustments are the most appropriate, given the circumstances of this case. See Rebuttal Testimony of TESI witness Gary Shambaugh, Tr. Vol. 2 pp. 194-198. We are mindful of the Staff's testimony in this area, but we do not find it persuasive. We agree

with the Company that the Staff testimony fails to take the actual size of the Foxwood system, which directly affects its cost of operation, into account. We hold that the Company's allocation of expenses to TESI's South Carolina facilities is the appropriate methodology to use, in that it assigns affiliate costs properly, using a logical basis, i.e. a combination of the numbers of customers and the relative size of the system.

(H) <u>Rate Case Expenses</u>

(1) Position of the Company: The Company proposes a rate case expense calculation including estimated expenses of $120,000 for water and $120,000 for sewer, less per book rate case expenses, amortized over a 3 year period. Company's combined proposed adjustment is $61,190.

(2) Position of the Staff: The Staff proposes a rate case expense adjustment based on actual expenses to May 2004. The Staff proposes that the Commission adopt actual rate case expenses of $136,710. Staff contends that the last rate case for TESI's predecessor company was filed in 1993, which is eleven years ago[2]. However, the Staff proposes to amortize the rate case expense over a more reasonable time period of 5 years. Thus, the proposed Staff combined adjustment is $13,995. The Staff stated in surrebuttal testimony that it did not object to updating rate case expenses for this proceeding for known and measurable expenses supported by invoices, however, no such additional invoices were proffered by the Company.

[2] The Commission notes that Staff is incorrect in this assertion. TESI's predecessor company actually filed its previous rate case on January 26, 1994. See Docket No. 93-670-W/S, Order No. 94-697, p. 1.

(3) Decision of the Commission: We adopt the part of the Staff's proposal to base rate case expenses on actual expenses through May 2004, or $136,710. Since the Company did not proffer any additional invoices for rate case expenses, we have no mechanism to update our consideration of these expenses.

We adopt TESI's proposal to utilize a 3-year amortization period. Ideally, the amortization period should be set for the period between rate cases. TESI has only provided service in South Carolina for a little over three years, and this is its first rate application. While it is true that the previous owner of Foxwood Hills filed its last rate case ten years ago, in 1994, TESI purchased this system through the bankruptcy sale approximately three and one half years ago. At that time, TESI also took over the appeal that was still pending from the 1994 rate proceeding. The Commission takes judicial notice of the fact that the Supreme Court did not rule upon that appeal until August 2002. TESI then filed the present rate application approximately one and one half years later, in March 2004. Since TESI has no other history in South Carolina to demonstrate the frequency with which it files rate applications, the only relevant evidence in the record on this issue is the fact that TESI owned and operated this system for approximately 3 years before it filed the present application.

In *Hamm v. South Carolina Public Service Commission,* 309 S.C. 282, 422 S.E.2d 110 (1992), the Supreme Court of South Carolina stated

> Adjustments for known and measurable changes in expenses may be necessary in order that the resulting rates reflect the actual rate base, net operating income, and cost of capital. The adjustments are within the discretion of the Commission and must be known and measurable within a

> degree of reasonable certainty. Absolute precision, however, is not required.
> (citing *Michaelson v. New England Tel. & Tel. Co.*, 121 R.I. 722, 404 A.2d 799 (1979)).

While the Commission cannot state with absolute precision when the Company will return for another rate proceeding, the Commission must provide a sufficient amortization period under which TESI may recover its expenses. After reviewing the Company's history in South Carolina, the Commission finds that an amortization period of three years is an appropriate time to recover the rate case expenses approved herein. The record supports a three-year amortization period as reflected in the testimonies of Witness Shambaugh.

Therefore, the Commission approves rate case expenses of $136,710, and sets a three-year amortization period for the recovery of those expenses. The result is an adjustment to the test year of $45, 570 for rate case expenses related to the instant case. We hold that the three-year amortization period is reasonable, and is the only amortization period supported by the evidence in this proceeding.

(I) <u>Depreciation Expense</u>

(1) Position of the Company: The Company proposes to include depreciation expense for the original plant in service based on an original cost study, adjusted to reflect 2003 plant additions.

The gross utility plant in service totals approximately $2,356,697 and $3,108,879 for the Foxwood water and sewer systems, respectively. When these capital amounts are depreciated based upon the original cost values when first dedicated to public service, the current net book values for water and sewer are as follows:

	Net Book Value
Water Utilities	$1,682,237
Sewer Utilities	2,067,522
	$3,749,759

TESI will be faced with the future liability of replacing the individual components of this fixed capital plant as they reach the end of their useful life. The inclusion of annual depreciation expense in the Company's annual revenue requirement provides for a systematic recovery of plant investment based upon life expectances of the individual asset and the recognition of the unavoidable loss of capital in providing service. Based upon this ratemaking concept, and utilizing appropriate service lives that are within industry standards, TESI asserts a depreciation expense adjustment of $42,534 for water and 64,988 for sewer, minus the Company's per book $5,821, for a total test year adjustment of $101,701. TR. Vol. 2, pp. 171-173. Application, pp. 6-7, Exhibits 2 and 3, and Schedules B and C.

(2) Position of the Staff: The Staff used the purchase price and plant additions since the Company was purchased and reduced this amount by tap fees and plant enhancement fees collected by the Company. As a result, the Staff takes the position that the Company has a negative rate base and therefore no depreciation expense is allowable. The staff's position is set forth in Hearing Exhibit 8, the exhibit to Staff witness Sharon

Scott's surrebuttal testimony. Staff made a combined adjustment to remove all depreciation expense from the books for the test year of ($5,821).

Staff proposed an alternative adjustment to TESI's capital plant, using the Company's depreciation study, and the Staff's own proposed adjustments. Based upon this approach, the Staff proposed adjusting TESI's rate base to equal $1,609,342. If the Commission were to accept this alternative Staff proposal, Staff's allowable depreciation expense adjustment would be $30,038, and interest expense (discussed below) adjustment would be $30,848. TR., Vol. 3, pp. 30-32.

(3) Decision of the Commission: We hold that TESI's proposed adjustment is appropriate and adopt same. We reject both Staff proposals.

Staff's approach contains a number of detailed deficiencies with which the Commission disagrees. For instance, in attempting to apportion the bankruptcy sale price to the Foxwood system, Staff has made the same conceptual error that it did in allocating TESI's affiliated services expenses. That is, Staff's allocation is based solely upon the number of customers at Foxwood. As discussed above, this approach ignores that the Foxwood systems are built to serve between 3,000 and 4,000 customers.

The reason we reject Staff's approach to making the adjustment to TESI's rate based is more fundamental than these detailed deficiencies. Up until 1991 and 1992, the annual reports filed with the Commission by the previous owner of this system reflected approximately $4.4 in gross plant for water and sewer. Then, systematically, in 1991 and 1992, that owner simply deleted these plant amounts from its books, and reduced its reported plant to zero. TR. Vol. 2, p. 268. The Commission takes judicial notice of the fact that the previous utility, Mountain Bay Estates Utility Company, Inc. ("Mountain Bay") never sought or received approval from this Commission to delete its gross plant from its books.

The major purposed of reflecting depreciation expense in water and sewer utility rates is to create a fund to assist the utility in replacing its capital assets as they are naturally consumed during the regular provision of service. Tr. Vol. 3, pp. 73-74. See also, *Hamm v. South Carolina Public Service Commission*, 307 S.C. 188, 198, 414 S.E.2d 149, 155 (S.C. 1992). Depreciation is an expense that ratepayers must bear under both the operating margin and rate base/rate of return methodologies. *Seabrook Island Property Owners Association v. South Carolina Public Service Commission*, 303 S.C. 493, 401 S.E.2d 672, 675 (S.C. 1991).

During the next two years, TESI will be required by DHEC to double the size of its existing wastewater treatment plant. DHEC is also requiring TESI to implement a solution to bring its water storage tank back on line. See, testimony of DHEC witness Raymond Peterson, Tr. Vol. 2, pp. 335-339, and Hearing Exhibit 6. In order to accomplish these requirements, TESI will have to attract financing sufficient to complete these projects. Tr. Vol. 2, pp. 107, 184. It will not be possible for TESI to attract this financing on commercially favorable terms unless it is able to show lenders that the Foxwood facilities have value, and that TESI's rates allow for the replacement of these facilities as they reach the end of their useful lives. *Id.*, pp. 217-219, 229, 230. In the long run Foxwood's ratepayers will benefit from favorable financing both through lower rates and more well-maintained water and sewer systems.

In contrast, Commission adoption of the Staff's proposed "negative rate base" would lead to the following serious consequences:

- The Company would not be able to recover principal and interest from the funds invested in capital.
- No financing would be available for future necessary projects.
- The "negative rate base" would cause a financial impairment of the Company's consolidated financial states.

Id., p. 478. This would, in turn, seriously impair the long-term financial viability of TESI's operations at Foxwood Hills. This condition would violate DHEC's financial viability requirements, and also create a serious impediment to further development at Foxwood Hills. Tr. Vol 2, p. 358-359.

For these reasons, the Commission adopts TESI's proposed $101,701 adjustment to depreciation expense.

(J) <u>Nonallowable Penalty</u>

(1) Position of Company and Staff: Both the Company and the Staff propose to remove a nonallowable penalty of $4,900 paid to DHEC. The payment was for a civil penalty in reference to a specific Consent Order.

(2) Decision of the Commission: We approve the adjustment.

(L) <u>Nonallowables</u>

(1) Position of the Company: The Company agrees with the Staff on this adjustment.

(2) Position of the Staff: Staff proposes to remove expenses which the Staff considers to be nonallowable for ratemaking purposes. These expenses include credit card penalties of $121, legal fees miscoded to the utility of $180, and a late payment fee for purchased water of $787.

(3) Decision of the Commission: We approve the Staff adjustments.

(M) <u>Property Taxes</u>

(1) Position of the Company and Staff: Both the Company and the Staff propose to reclassify property taxes that were incorrectly booked to the water system. The adjustment corrects the allocation between water and sewer.

(2) Decision of the Commission: We approve the adjustment.

(N) <u>Gross Receipts Tax on Present Revenues</u>

(1) Position of the Company: The Company proposed an assessment rate of .01324 for water operations and taxable revenues of $113,642. The Company computed an amount of $1,739 less the per book gross receipts of $1,613 for an adjustment of $126. The Company used a factor of .00696 for sewer operations and taxable revenues of $148,728. The Company computed an amount of $1,270 less the per book amount of $1,065 for an adjustment of $205. The combined Company adjustment amounted to total taxes of $3,009 less the per book amount of $2,678 for an adjustment of $331. In rebuttal

testimony, the Company stated that it did not disagree with the utilization of the current gross receipts factors, but that the final adjustment for an annual revenue requirement must be based upon Commission approved pro forma revenues. See Rebuttal testimony of Company witness Gary Shambaugh at 14.

(2) Position of the Staff: The Staff used the most recent PSC assessment rate of .007110428 and its present revenues for water of $108,267 for a computed amount of $770 less the per book amount of $1,613 resulting in an adjustment of ($843). For sewer operations, Staff used present revenues of $144,657 and the gross receipts factor of .007110428 for a computed amount of $1,029 less the per book amount of $1,065 for an adjustment of ($36). The combined adjustment totaled $1,799 less the per book amount of $2,678 for an adjustment of ($879).

(3) Decision of the Commission: We adopt Staff's adjustments, which are based on the current gross receipts factor and appropriate pro forma revenues.

(O) Interest Expense

(1) Position of the Company: The Company proposes to include Interest Expense as an above-the-line operating expense in the amount of $14,258.

(2) Position of the Staff: The Staff does not consider interest expense as an operating expense, but includes it, if applicable, when computing the Operating Margin. The Staff states that the Company has a negative rate base and therefore no interest expense should be allowed, either above or below the line.

(3) Decision of the Commission: We agree with the Staff that interest expense should be considered below the line when computing operating margin. Staff bases is proposal to disallow interest expense upon its asserted negative rate base. Since the Commission has rejected Staff's proposed negative rate base, The Commission holds that $14,258 in interest expense will be considered below the line in computing the Company's operating margin.

(P) Gross Receipts Tax on Revenues After the Proposed Increase

(1) Position of the Company: The Company used an assessment rate of .01324 for water operations and taxable revenues of $433,150. The Company computed an amount of $5,970 less the as adjusted amount of $1,739 for an adjustment of $4,231. The Company used a factor of .00696 for sewer operations and its taxable revenues of $369,285. The Company computed the amount of $2,805 less the as adjusted amount of $1,270 for an adjustment of $1,535. In its rebuttal testimony, the Company stated again that it did not disagree with the utilization of the current gross receipts factors, but that the final adjustment for an annual revenue requirement must be based on Commission approved pro forma revenues. Id. at 15.

(2) Position of the Staff: The Staff used the most recent PSC assessment rate of .007110428 and its after the proposed revenue amount for water of $426,929 for a computed amount of $3,036 less the as adjusted amount of $770, resulting in an adjustment of $2,266. For sewer operations, Staff used the after the proposed increase revenue of $364,485 and the gross receipts factor of .007110428 for a computed amount

of $2,592 less the as adjusted amount of $1,029 for an adjustment of $1,563. The combined adjustment amounted to $3,829.

(3) Decision of the Commission: We adopt Staff's adjustments, which are based on the current gross receipts factor and appropriate pro forma revenues.

(Q) <u>Adjustment of Income Taxes for Effect of the Proposed Increase</u>

(1) Position of the Company: The Company used its water taxable revenues of $433,150 and a state tax rate of 5.0% and a federal tax rate of 34%, resulting in an adjustment after expenses of $4,406 for state taxes and $28,460 for federal income taxes. The Company used its sewer taxable revenues of $369,285 and a state tax rate of 5.0% and a federal tax rate of 34%, resulting in an adjustment after expenses of $3,756 for state taxes and $24,264 for federal income taxes. The combined adjustment amounted to $32,866 for water, $28,020 for sewer, and total taxes of $60,886. The Company disagrees with the Staff's income tax calculations, since they do not reduce the claim for interest expense and the taxes are based on "excessive" margins.

(2) Position of the Staff: The Staff used the after the proposed increase revenues for water of $426,929 and sewer of $364,485 less operating expenses for taxable income. Staff used a 5% state tax rate and 34% federal tax rate resulting in an adjustment of $70,839 for water, $78,465 for sewer and $149,304 for combined operations. Staff also states that, since the Company has a negative rate base, that no interest expense should be utilized in calculating income taxes.

(3) Decision of the Commission: The Company and Staff approaches are conceptually identical, except that the Staff has excluded interest expense from its calculation. Since the Commission has rejected the Staff's position on rate based and interest expense, we adopt the Company's proposal.

Summary of Adopted Adjustments to Expenses:

[The Company has purposefully left this section blank so that the Commission may complete it in accordance with its findings and appropriate utility accounting standards.

7. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 7

The Commission adopts its conclusions regarding TESI's rate based fully set forth in the evidence and conclusions related to the depreciation expense adjustment, above.

[TESI proposes that the remaining portion of this order reflect the expense and rate base adjustments set forth in the preceding sections.]

IT IS THEREFORE ORDERED THAT:

1. TESI is granted a rate of return on rate base for its water and sewer operations in South Carolina of 10.75%.

2. The schedule of rates and charges attached hereto as Appendix A is hereby approved for service rendered on or after the date of this Order. Further, the schedules are

deemed to be filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (2003).

3. Should the schedules approved herein and attached hereto as Appendix A not be placed in effect until three (3) months from the effective date of this Order, the schedules shall not be charged without written permission from the Commission.

4. TESI shall maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class B Water and Sewer Utilities, as adopted by this Commission.

5. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

____
Chairman

ATTEST:

____
Executive Director

(SEAL)